

# CHINA LEGAL REPORT\*

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## **RMB Settlement in Cross border Trade**

### **I Introduction**

The pilot program of RMB settlement in cross-border trade (hereinafter referred to as “the Pilot Program”) kicked off in July 2009. It was adopted to face the international economic crisis and for the purpose of improving the PRC export business. The Pilot Program has significantly increased opportunities for cross-border settlements and international payments by foreign enterprises. With enhanced and accelerated growth of the trade and investment of China with the rest of the world, there is an increasing demand for using RMB as a means of payment.

In June 2010, for the purpose of responding to the requirements of markets and enterprises both in China and abroad, the competent authorities expanded the Pilot Program further to 20 provinces (autonomous regions and municipalities). At the same time the overseas coverage of the Pilot Program was expanded from Hong Kong, Macao and the ASEAN countries to all countries and regions. In August 2011, the competent authorities expanded the Pilot Program once again. The coverage of the Pilot Program within the domestic territory was expanded nationwide.

With the expansion of the Pilot Program, especially when more European and USA banks enter into RMB settlement agreements with Chinese banks, more foreign companies are able to use RMB to pay their Chinese suppliers and receive RMB payments from Chinese purchasers. It is good news for foreign companies developing their business in China.

This issue of our China Legal Report will provide you with a comprehensive introduction of the Pilot Program and present you practical issues with RMB settlement in cross-border.

### **II Advantages of the Pilot Program**

The Pilot Program shall bring actual benefits to enterprises. Before the implementation of the Pilot Program the trade between PRC enterprises and overseas enterprises were usually settled on the basis of USD, EUR and Japanese Yen.

For PRC enterprises, the Pilot Program can reduce the risks imposed to them by exchange rate fluctuation, simplify the procedures, and in the meantime cut down their costs spent on foreign exchange sale and purchase. Moreover, the Pilot Program may also help enterprises fixing the cost and take initiative in the long term financial planning. When both production costs and profit are denominated in a common currency like the RMB, there will be greater certainty for enterprises engaging in external trade. In this context, the Pilot Program could also stimulate trade activity.

When using the currency of the third country to conduct the trade settlement, enterprises which are not in the US, Europe and Japan also face considerable risk from fluctuating exchange rates, and are exposed to potential foreign exchange losses. With the implementation of the Pilot Program, exchange rate fluctuation can be effectively avoided.

For enterprises in the US, Europe and Japan, RMB settlement in cross-border trade means another monetary choice. The Pilot Program provides such enterprises with the flexibility to choose the currency of settlement that best suits their needs. Moreover, it is reported that most Chinese pilot enterprises tend to use RMB for cross-border trade settlement, if overseas enterprises can choose RMB as the settlement currency.

Of course, whether enterprises are willing to settle their trades in RMB will also depend on exchange rate expectations. Overseas enterprise may well be attracted to RMB settlements as the Chinese currency continues to appreciate.

### **III Development and Applicable Laws**

#### **1. July 2009 – The Pilot Program kicked off**

On April 8, 2009, the State Council of China decided to carry out pilot program of RMB settlement for cross-border trade in Shanghai, Guangzhou, Shenzhen, Zhuhai and Dongguan. The overseas territory for the Pilot Program was defined as Hong Kong, Macao and the ASEAN countries.

Based on the above decision, the People's Bank of China, the Ministry of Finance, the Ministry of Commerce, the General Administration of Customs, the State Administration of Taxation and the China Banking Regulatory Commission (hereinafter referred to as "the Six Departments") jointly formulated Measures for the Administration of Pilot RMB Settlement in Cross-border Trade (hereinafter referred to as "the Measures") on 1 July 2009, and the People's Bank of China issued the Detailed Rules for the Implementation of the Measures for the Administration of Pilot RMB Settlement in Cross-border Trade (hereinafter referred to as "the Implementation Rules") on 3 July 2009.

Not all enterprises in the five pilot cities could benefit from the Pilot Program. Only pilot enterprises (the so-called Mainland Designated Enterprises "MDE") shall be recommended by the local government and then be subject to the verification and authorization of the Central Bank in joint work with relevant authorities. Pilot enterprises shall be enterprises with a truthful registration and genuine capital contribution and have actual business premises in the relevant pilot area. If the identity of a domestic enterprise cannot be verified, domestic settlement banks should not provide it with RMB settlement services for cross-border trade.

It is important here to note that the list of pilot enterprises is recommended by the local government and finalized by the Six Departments. There is no regulation regarding specific requirements to apply for the pilot enterprise. In other words, the initiative lies in the hands of the government and relevant authorities.

If an enterprise wants to become a pilot enterprise, it should express its willingness first. Generally, enterprises with rich experience of international settlement business, sound credibility and conducting business in compliance with regulations of taxation, commerce, customs and foreign exchange administration will have higher chances of being selected as pilot enterprises.

In accordance with the Measures and the Implementation Rules, RMB clearing and settlement in cross-border trade may be handled in two ways:

- (1) through a RMB clearing bank in Hong Kong or Macau

A “RMB clearing bank in Hong Kong or Macau” means a commercial bank which has been approved by the People's Bank of China and the Hong Kong (Macau) Monetary Authority, and which has joined in the People's Bank of China's large-amount Payment System and provided RMB clearing services in Hong Kong or Macau.

- (2) through a domestic commercial bank (“Domestic Agent Bank”) acting as the agent of an overseas commercial bank (“Overseas Participating Bank”)

The Domestic Agent Bank should enter into an RMB settlement agency agreement with the Overseas Participating Bank to set out the rights and obligations of the parties, and the conditions and procedures of opening, changing and cancelling accounts. The Domestic Agent Bank shall open a RMB inter-bank transaction account for the Overseas Participating Bank and settle RMB payments in cross-border trade as the agent of the Overseas Participating Bank. The RMB settlement agency agreement and the opening and any change and cancellation of RMB inter-bank transaction account should be reported by the Domestic Agent Bank to local branch of People's Bank of China for the record.

## **2. June 2010 - the Pilot Program has been expanded**

Since the Pilot Program was initiated in July 2009, the channels for RMB settlement and clearing have kept convenient and expedite. The Pilot Program was universally hailed by pilot enterprises. To satisfy the actual demand of enterprises for RMB settlement in cross-border trade and let RMB settlement further play its role in promoting trade and investment facilitation, the Six Departments jointly released the Notice on the Relevant Issues Concerning the Expansion of Pilot RMB Settlement in Cross-border Trade (hereinafter referred to as “the Notice”) on June 17, 2010.

The Notice expanded the pilot area of cross-border trade RMB settlements to 20 provinces, autonomous regions and municipalities, including Beijing, Tianjin, Inner Mongolia, Liaoning, Jilin, Heilongjiang, Shanghai, Jiangsu, Zhejiang, Fujian, Shandong, Hubei, Guangdong, Guangxi, Hainan, Chongqing, Sichuan, Yunnan, Tibet and Xinjiang. Furthermore, the overseas coverage of RMB settlement in cross-border trade was expanded from Hong Kong, Macao and the Association of Southeast Asian Nations to all countries and regions.

It needs to mention that after the expansion of pilot provinces, all enterprises in the 20 pilots provinces can settle in RMB for goods import, cross-border service and other common trading. However, in 16 pilot provinces (Beijing, Tianjin, Inner Mongolia, Liaoning, Shanghai, Jiangsu, Zhejiang, Fujian, Shandong, Hubei, Guangdong, Guangxi, Hainan, Chongqing, Sichuan and Yunnan) among those 20 provinces, only pilot enterprises are allowed to use RMB to settle for their exported goods. And enterprises in Inner Mongolia, Liaoning, Jilin, Heilongjiang, Guangxi, Yunnan, Tibet and Xinjiang which have import and export operation rights are allowed to conduct general trading and cross boarder small amount trading with the neighbouring countries at designated ports using RMB settlement.

### **3. January 2011 - the pilot RMB Settlement for Overseas Direct Investment**

Following the launch of the pilot program of RMB settlement in cross-border trade, the People's Bank of China promulgated the Administrative Measures for Pilot RMB Settlement for Overseas Direct Investment on 13 January 2011 (hereinafter referred to as "the Administrative Measures"). The Administrative Measures point out that banks and enterprises located in pilot areas of cross-border trade RMB settlement can implement RMB settlement of overseas direct investment.

The Administrative Measures specify that domestic enterprises approved to engage in overseas direct investments can carry out overseas direct investments using RMB. Banks may process RMB settlement for enterprises on the basis of approved certificates or documents issued by administrative overseas direct investment authorities.

The progress of RMB settlement for overseas direct investment will enhance RMB's usage in cross border trades and investment, thus better support Chinese enterprises to go abroad and facilitate trades and investments.

### **4. RMB Settlement for Foreign Direct Investment**

On June 3, 2011 the People's Bank of China (PBC) issued Circular on Relevant Issues Clarifying Cross-Border RMB Business (Circular).

The Circular stipulates that banks may conduct cross-border trade, other current projects, foreign direct investment, foreign loans business and other cross-border investment and

financing RMB clearing business approved by the PBC via domestic agent banks, clearing banks for RMB business in Hong Kong and Macao, and RMB bank settlement accounts opened by foreign institutions in China. In addition, the Circular requires overseas participating banks to conduct only RMB purchase and sales business for trade projects which have domestic enterprises as payees or payers, and not to conduct RMB purchase and sales business without direct trade payments to domestic enterprises.

Moreover, the Circular clarifies pilot measures for foreign direct investment (FDI) RMB settlements; the case is currently in a pilot phase.

According to the Circular, the state regulation of restricted categories of projects and priorities will not be accepted for RMB FDI. Projects including funding for newly established companies, mergers and acquisitions of domestic enterprises, equity transfer and capital increase of existing enterprises, providing shareholder loans can be applied for conducting FDI in RMB in accordance with the following procedure :

- (1) Foreign investors or foreign-invested enterprises within the territory submit the pilot application together with the approval certificate (issued by competent MOFCOM) to the branch of PBC;
- (2) The branch of PBC will review the applications for approval, and then report it to the central bank;
- (3) The central bank will hold a meeting to consider the pilot case;
- (4) After the application is approved by the central bank, the central bank will reply to the branch of PBC. The branch of PBC will provide a notice to the relevant settlement bank;
- (5) Having obtained the notice, the settlement bank will handle the RMB settlement for foreign investors or foreign-invested enterprises within the territory;

The settlement bank shall supervise and record the use of RMB funds in the territory of the approved range in strict accordance with the central bank's approval.

#### **5. August 2011 - the Pilot Program was expanded nationwide**

The Six Departments jointly released the Notice on the Expansion of Regions for Cross-Border Trade RMB Settlements (hereinafter referred to as "the Notice") in August, 2011.

According to the Notice, the pilot area of cross-border trade RMB settlements was expanded to another 11 provinces and autonomous regions, including Hebei, Shanxi, Anhui, Jiangxi, Henan, Hunan, Guizhou, Shaanxi, Gansu, Qinghai and Ningxia. Again, all enterprises in these 11 provinces can carry out goods import, cross-border service and other common trading using RMB to settle and only pilot enterprises can carry out goods exports using RMB settlement.

The Notice also clarifies that the scope of overseas territories for pilot enterprises implementing export trading in Jilin, Heilongjiang, Tibet and Xinjiang will be extended from neighbouring countries to all countries and regions.

Finally, the coverage of the Pilot Program within the domestic territory was expanded all over China.

## **6. Special treatment of RMB settlement in cross-border trade**

### **(1) Export tax refund**

Export transactions settled in RMB shall apply the export tax rebate (exemption) policies. The pilot enterprises are not required to provide the verification forms for export collection of foreign exchange when applying for tax refund and exemption for exported goods in the cross-border trade with RMB settlement, but should make a separate declaration to the taxation authorities. If the declaration is made together with other exported goods, the exported goods in cross-border trade with RMB settlement should be highlighted in the declaration forms.

### **(2) Rules regarding foreign exchange**

According to the “Circular on the Relevant Issues Regarding the Statistics and Declarations of International Receipts and Payment for RMB Settlement in Cross-Border Trade” issued by the State Administration of Foreign Exchange, the RMB flow and stock information arising from RMB settlement in cross-border trade falls into the scope of the statistics and declaration of international receipts and payments, the declaration procedures should be handled in accordance with the Measures for the Statistics and Declarations of International Receipts and Payment and the relevant rules.

When pilot enterprises receive cross-border RMB payments, they should complete the “Declaration Form for Foreign-related Income” and comply with the declaration procedures within five working days. When enterprises make external RMB payments, they should make the declaration in parallel with submitting the “Application Form for Overseas Remittances” or the “Advisory Note on External Payments/Acceptances.”

### **(3) Rules regarding customs**

The RMB settlement in cross-border trade should not come under the administration of foreign exchange verification and the verification forms for export collection of foreign exchange is also not required for customs declaration. The customs is not responsible for examining and verifying whether the enterprise is a pilot enterprise.

## IV Case Study

In the following two standard situations shall illustrate the application of the current laws and regulations in practice:

### Case 1: Export

A company, established and registered in Shanghai (“Shanghai Company”) sells goods to an European company (“European Company”). The European Company wants to pay the purchase price in RMB. What are the preconditions for such transaction?

1. The Shanghai Company shall be registered as a Mainland Designated Enterprise (MDE). Since the Pilot Program has been extended to all countries and regions worldwide, the European company does not have to register at or obtain approval from a Chinese authority.
2. The Shanghai Company shall have a RMB settlement account. In addition, it should choose one domestic settlement bank as the main reporting bank for RMB settlement. The main reporting bank will bear the duty of bringing to their attention of obligations on reporting and filing of related data and information.
3. In order to pay in RMB, the European Company should also have a RMB settlement account. Such RMB settlement account can be opened either (i) offshore with a clearing bank in Hong Kong or Macau or in an overseas participating bank or (ii) onshore within mainland China with a Chinese bank as a non-resident account<sup>1</sup>.
4. When applying for RMB settlement business, the Shanghai Company should provide the time or expected time of export declaration, and relevant information of export transactions to its domestic settlement bank, truthfully fill out the description of export receivables, and cooperate with the domestic settlement bank in the examination and verification of the authenticity and consistency of trade documents.

After the corresponding goods are declared at the customs, or are failed to be declared to the customs as scheduled, the Shanghai Company should notify its domestic settlement bank of the actual time of declaration or the adjusted expected time of declaration in a timely manner.

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<sup>1</sup> On August 31, 2010, the People’s Bank of China issued the Measures for the Administration of RMB Bank Settlement Accounts of Overseas Institutions, which stipulates that a non-resident enterprise may apply for opening a bank settlement account in a bank for carrying out various cross-border RMB businesses according to law. According to this Notice, the European Company can also open a RMB settlement account in a bank within China.



5. After receiving the RMB payment, the Shanghai Company should fill the Declaration Form for Foreign-related Receipts and make a declaration within five working days.
6. Applying for tax refund and exemption for exported goods according to provisions mentioned in Chapter III.6.(1).

#### Case 2: Import

A Shanghai Company (“Shanghai Company”) purchases from a European Company (European Company”) goods. The Shanghai Company wants to pay in RMB.

1. For the payment of the purchase price of imported goods, the Shanghai Company does not have to be registered as a MDE. The European Company does not have to be registered, either.
2. The Shanghai Company as well as the European Company shall have a RMB account (for details refer to Case 1, points 2 and 3).
3. When applying for RMB settlement of a specific transaction, the Shanghai Company should provide the time or expected time of import declaration, and relevant information of import transactions to its domestic settlement bank, truthfully fill out the description of import payment, and cooperate with the domestic settlement bank in the examination and verification of the authenticity and consistency of trade documents.

After the corresponding goods are declared to the customs, or are failed to be declared to the customs as scheduled, the Shanghai Company should notify the domestic settlement bank of the actual time of declaration or the adjusted expected time of declaration in a timely manner.

4. After making an outward payment in RMB, the Shanghai Company should submit the Application Form for Overseas Remittance or the Advisory Note on External Payments/Acceptances and make a declaration at the same time.

The following points shall be taken into consideration from a practical point of view for both type of transactions (Import and Export):

1. The Shanghai Company should guarantee the authenticity of the cross-border trade settled in RMB, and should establish a ledger for RMB settlement of cross-border trade to keep an accurate record of import and export declaration and of RMB receipt and payment. When handling the business for the first time, the Shanghai Company should provide the name of enterprise, organization code, customs code, tax

registration number, identity cards of the legal representative and the person in charge of the enterprise, and other information to its domestic settlement bank.

2. If the RMB funds paid in advance to or by the Shanghai Company exceeds 25% of the total contract price, the Shanghai Company should provide the contract to its domestic settlement bank.
3. In case 1, if the Shanghai Company fails to transfer its RMB income to domestic banks within 210 days after the export of the relevant goods, it should submit to the Cross-border RMB Receipt and Payment Information Management System through its domestic settlement bank within 5 working days thereafter the outstanding amount and serial number of the corresponding export declaration form, and meantime provide related data and information to its domestic clearing bank.
4. In case 1, if the Shanghai Company intends to remain its RMB export proceeds overseas, it should report to the local branch of People's Bank of China through its domestic settlement bank for the record, and submit the amount of the RMB funds to be remained overseas, the opening bank, account information, use of the funds and the serial number of the corresponding export declaration form to the Cross-border RMB Receipt and Payment Information Management System.

## V Conclusion

RMB settlement in cross-border trade is still in its initial stage. It cannot be realized over one night and still has a long way to go. It is expected by Chinese banking experts that a basic convertibility of the RMB will likely be achieved before 2016, whereas a full convertibility of the RMB might arrive before 2020.

However, to adopt RMB settlement in cross-border trade shows the global market's confidence to the PRC's economy. Since continued appreciation of the RMB against the US dollar in the medium to long run is very likely and the Chinese legal framework has in principle opened the market for the use of RMB raised offshore (particularly on the capital market in Hong Kong) for foreign direct investments in mainland China, we have reason to believe that more and more domestic and overseas enterprises will use the RMB for international trade settlements.

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We may be reached under the following addresses:

**Zurich**

Wenfei Attorneys-at-Law Ltd.  
Mainaustrasse 19  
CH-8008 Zurich, Switzerland  
T +41 43 210 8686  
F +41 43 210 8688

**苏黎世**

瑞士文斐律师事务所  
Mainaustrasse 19 号  
CH-8008 瑞士文斐律师事务所  
电话: +41 43 210 86 86  
传真: +41 43 210 86 88

**Beijing**

Wenfei Attorneys-at-Law Ltd.  
Room 901, Beijing Silver Tower,  
No. 2, North Rd. Dong San Huan,  
Chaoyang District,  
Beijing 100020 P.R.C.  
T +86 10 6468 7331  
F +86 10 6460 3132

**北京**

瑞士文斐律师事务所北京代表处  
中国北京朝阳区东三环北路2号  
北京南银大厦901室  
邮编 100027  
电话: +86 10 6468 7331  
传真: +86 10 6460 3132

**Shanghai Cooperation:**

Wenfei Consulting  
Room 501, Tower 3,  
X2 Creative Park,  
No.20 Cha Ling Bei Lu,  
Shanghai 200032  
T +86 21 5170 2370  
F +86 21 5170 2371

**上海合作单位:**

文斐商务咨询(上海)有限公司  
中国上海市茶陵北路20号  
X2徐汇创意空间3幢501室  
邮编200032  
电话: +86 21 5170 2370  
传真: +86 21 5170 2371

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